



LEGAL AFFAIRS
400 R STREET, SUITE 3090
SACRAMENTO, CA 95814-6200



April 11, 1996

APR 12 1996

FEDERAL ROOM

DOCKET FILE COPY ORIGINAL

OVERNIGHT FEDERAL EXPRESS MAIL

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

RE: In the Matter of the Notice of Proposed Rule Making and Order Establishing Federal-State Joint Board on Universal Service - CC Docket No. 96-45

Gentlepersons:

Enclosed please find an original and 10 copies of the "Comments of the California Department of Consumer Affairs to Notice of Proposed Rule Making and Order Establishing Federal-State Joint Board on Universal Service" dated April 5, 1996. Please file this document in the above matter, and return an endorsed copy to me in the enclosed stamped, self-addressed return envelope. Pursuant to FCC Rule 1.419, we have enclosed an additional five copies of our Comments for distribution to each of the Commissioners.

Thank you for your assistance.

Sincerely,

VIRGINIA J. TAYLOR
Staff Counsel

Enclosures

No. of Copies rec'd
List ABCDE

0210

The Honorable Reed E. Hundt, Chairman
Federal Communications Commission
1919 M Street, N.W. - Room 814
Washington, D.C. 20554

The Honorable Andrew C. Barrett
Commissioner
Federal Communications Commission
1919 M Street, N.W. - Room 826
Washington, D.C. 20554

The Honorable Susan Ness, Commissioner
Federal Communications Commission
1919 M Street, N.W. - Room 832
Washington, D.C. 20554

The Honorable Julia Johnson, Commissioner
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

The Honorable Kenneth McClure
Vice Chairman
Missouri Public Service Commission
301 W. High Street, Suite 530
Jefferson City, MO 65102

The Honorable Sharon L. Nelson, Chairman
Washington Utilities and Transportation
Commission
P.O. Box 47250
Olympia, WA 98504-7250

The Honorable Laska Schoenfelder
Commissioner
South Dakota Public Utilities
Commission
500 E. Capital Avenue
Pierre, SD 57501

Martha S. Hogerty
Public Counsel for the State of Missouri
P.O. Box 7800
Harry S. Truman Building, Room 250
Jefferson City, MO 65102

Deborah Dupont, Federal Staff Chair
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Paul E. Pederson, State Staff Chair
Missouri Public Service Commission
P.O. Box 360
Truman State Office Building
Jefferson City, MO 65102

Eileen Benner
Idaho Public Utilities Commission
P.O. Box 83720
Boise, ID 83720-0074

Charles Bolle
South Dakota Public Utilities Commission
State Capital, 500 E. Capital Avenue
Pierre, SD 57501-5070

William Howden
Federal Communications Commission
2000 L Street, N.W., Suite 812
Washington, D.C. 20036

Lorraine Kenyon
Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, AK 99501

Debra M. Kriete
Pennsylvania Public Utilities Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Clara Kuehn
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Mark Long
Florida Public Service Commission
2540 Shumard Oak Boulevard
Gerald Gunter Building
Tallahassee, FL 32399-0850

Samuel Loudenslager
Arkansas Public Service Commission
P.O. Box 400
Little Rock, AR 72203-0400

Sandra Makeeff
Iowa Utilities Board
Lucas State Office Building
Des Moines, IA 50319

Philip F. McClelland
Pennsylvania Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, Pennsylvania 17120

Michael A. McRae
D.C. Office of the People's Counsel
1133 15th Street, N.W. - Suite 500
Washington, D.C. 20005

Rafi Mohammed
Federal Communications Commission
2000 L Street, N.W., Suite 812
Washington, D.C. 20036

Terry Monroe
New York Public Service Commission
Three Empire Plaza
Albany, NY 12223

Andrew Mulitz
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Mark Nadel
Federal Communications Commission
1919 M Street, N.W., Room 542
Washington, D.C. 20554

Gary Oddi
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Teresa Pitts
Washington Utilities and Transportation
Commission
P.O. Box 47250
Olympia, WA 98504-7250

Jeanine Poltronieri
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

James Bradford Ramsay
National Association of Regulatory Utility
Commission
1201 Constitution Avenue, N.W.
Washington, D.C. 20423

Jonathan Reel
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Brian Roberts
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3298

Gary Seigel
Federal Communications Commission
2000 L Street, N.W., Suite 812
Washington, D.C. 20036

Pamela Szymczak
Federal Communications Commission
2000 L Street, N.W., Suite 257
Washington, D.C. 20036

Whitnig Thayer
Federal Communications Commission
2000 L Street, N.W., Suite 812
Washington, D.C. 20036

Deborah S. Waldbaum
Colorado Office of Consumer Counsel
1580 Logan Street, Suite 610
Denver, Colorado 80203

Alex Belinfante
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Larry Povich
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Virginia J. Taylor
Department of Consumer Affairs
Legal Services Unit
400 R Street, Suite 3090
Sacramento, CA 95814-6200

ORIGINAL

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

APR 12 1996

FEDERAL COMMUNICATIONS COMMISSION

In the Matter of the Notice of Proposed)
Rule Making and Order Establishing Federal-)
State Joint Board on Universal Service)
_____)

CC Docket No. 96-45

DOCKET FILE COPY ORIGINAL

COMMENTS OF CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS
TO FCC'S NOTICE OF PROPOSED RULE MAKING AND ORDER
ESTABLISHING FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

VIRGINIA J. TAYLOR
RICHARD A. ELBRECHT

Attorneys for

CALIFORNIA DEPARTMENT OF
CONSUMER AFFAIRS
400 R Street, Suite 3090
Sacramento, CA 95814-6200
(916) 445-5126

April 11, 1996

EXECUTIVE SUMMARY

The comments of the California Department of Consumer Affairs ("DCA") identify principles it believes should guide the Federal Communications Commission ("FCC") in its implementation of the Telecommunications Act of 1996 ("Act"), and apply them to key issues addressed in this Notice of Proposed Rule Making. The DCA's comments reflect its focus on the broad interest of the whole consumer, both residents and businesses, both affluent and poor, in all their capacities including worker, assistance recipient, investor, etc.

The principles governing the interpretation of statutes require that they be interpreted and implemented in ways which carry out the underlying policy and intent. Here, Congress has mandated that the FCC interpret the Act in a manner which relies on more competition and less regulations as means to encourage innovation and constrain prices.

Consumers will benefit most from a competitive market. There, consumer choice influences the design of services, determines what services are deployed, and operates to keep prices fair, reducing the need for a costly regulatory process and subsidy program.

Consumers will benefit most from a market where innovation is encouraged, where new services are developed to meet the requirements of consumers, and where new technologies are employed to provide services in the most cost-effective manner.

Because regulation stifles both competition and innovation, consumers also will benefit from reduced regulation. To the extent that regulatory mechanisms antagonistic to a competitive marketplace must be applied, they should be based on sound principles and consumer necessity, and should be narrowly focused.

There are valid public policy reasons for adopting a policy of universal access. Those include the benefits of being able to connect with other people, businesses and government,

making the most efficient use of fixed plant, and providing a broader showcase for new services, equipment and applications.

The goals of universal service are partly achievable without explicit government intervention, provided that the dynamics of competition are fostered and mobilized. The nation should avoid financing universal service by needlessly overpricing other services. Above all, universal service subsidies should be targeted to those who truly need them.

Rates which are "reasonably comparable," and "just" and "reasonable" are rates which reflect the cost of providing service to customers, including any additional costs resulting from geography, climate, density or other similar factors. Whether rates are "affordable" depends on the income of the customers; "affordable" rates for the near-poor are different from "affordable" rates for those who are affluent. Any universal service subsidy should be based on need, not geography.

The requirement that subsidies be "explicit" means that both the subsidy payor and the subsidy receiver should be aware of the amount of the subsidy. The DCA supports an explicit subsidy mechanism in which customers are provided with that information. Only then can people determine whether the benefits of the subsidy program outweigh its costs.

The most beneficial action the FCC can take to assist in the availability and deployment of advanced services to schools, libraries and health care providers is to provide incentives for the private market to deploy a fiber optic, broadband, network platform.

The DCA supports the FCC's concept of a variety of services for low income customers. However, the choice to offer those services should be made first by the telecommunications industry, and second by state regulators.

TABLE OF CONTENTS

APR 12 1996

FOI MAIL ROOM

I. INTRODUCTION	1
II. GUIDING PRINCIPLES	2
A. Legal Principles of Interpretation	2
B. Interpret and Implement the Act to Promote Competition and Reduce Regulation and Thereby Encourage Innovation and Constrain Prices	2
1. The Consumer Interest in Fostering Competition	3
2. The National Interest in Fostering Competition and Innovation	4
3. Avoiding Perversely Counterproductive Regulation	5
4. The Regulatory Options	6
5. Guiding Principles	8
C. States Should Interpret and Implement the Act with Respect to Intrastate and Local Exchange Issues	8
III. APPLICATION OF THESE PRINCIPLES TO THE UNIVERSAL SERVICE SUBSIDY PROGRAM	9
A. Design Universal Service Subsidies to Carry Out the Policies Which Justify Them	9
B. Financing Universal Service Subsidies	11
C. Targeting Universal Services Subsidies	12
IV. SUGGESTED INTERPRETATION OF SPECIFIC PORTIONS OF THE ACT RELATING TO UNIVERSAL SERVICE	14
A. What <u>Are</u> "Reasonably Comparable" Rates?	15
B. What <u>Are</u> "Just, Reasonable and Affordable" Rates?	17
C. Subsidies Must be "Explicit"	20
D. Serving Schools, Libraries, and Health Care Providers	21
E. Special Services for Low-Income Customers	23
V. CONCLUSION	24

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

APR 12 1996
FCC MAIL ROOM

In the Matter of the Notice of Proposed)
Rule Making and Order Establishing Federal-) CC Docket No. 96-45
State Joint Board on Universal Service)
_____)

**COMMENTS OF CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS
TO FCC'S NOTICE OF PROPOSED RULE MAKING AND ORDER
ESTABLISHING FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE**

I. INTRODUCTION.

The California Department of Consumer Affairs (DCA) hereby respectfully submits the following comments in response to the above-captioned Notice of Proposed Rule Making (NPRM) and Order Establishing Federal-State Joint Board on Universal Service.¹

The DCA represents the broad interest of all consumers, both residents and businesses, both rich and poor, and in their many roles, including end users of services, wage earners and employees of businesses, assistance recipients, and investors in America's business, all of whom have a stake in our economy. The DCA will limit its comments to the identification of several general principles it believes should guide the FCC and the Federal-State Joint Board ("Joint Board") in implementing the Telecommunications Act of 1996 ("Act"), and the application of those principles to some of the key issues.

¹ FCC 96-93, In the Matter of Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, adopted March 8, 1996 (hereinafter "NPRM"), at p. 3. The purpose of the NPRM is to: (1) define the services that will be supported by Federal universal service support mechanisms; (2) define those support mechanisms; and (3) otherwise recommend changes to FCC regulations to implement the universal service directives of The Telecommunications Act of 1996.

II. GUIDING PRINCIPLES.

A. Legal Principles of Interpretation.

The Act is an intricate patchwork of consensus among legislators and interested parties. As a result, some of its provisions might appear to conflict. When such conflicts arise, they can be resolved by applying established principles.

The primary rule of construction of statutes is to ascertain and carry out Congressional intent. In construing statutes with conflicting or doubtful meaning, the goals should be to fully promote the Congressional policy and intention that underlie the statute, and avoid constructions which would alter or defeat that policy and intent. (73 Am.Jur.2d, Statutes, § 145, p.351.) Even the literal meaning of the terms in the statute should not be used to defeat the manifest policy intended to be promoted. (*Id.*, § 153, at p. 357.)

B. Interpret and Implement the Act to Promote Competition and Reduce Regulation and Thereby Encourage Innovation and Constrain Prices.

The preamble to Senate Bill 652 states that the Act's purpose is "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." Additionally, the preamble to the Joint Explanatory Statement of the Committee of Conference ("Joint Conference Statement") states that the purpose of the Act is "to provide for a procompetitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition." Both of these reflect a strong focus on promoting competition and reducing regulation as a way to encourage innovation and constrain prices.

Moreover, Congress has specifically given the Federal Communications Commission ("FCC") the power not to apply any provision of the Act if it makes certain findings. (Act, § 401(a).) In so doing, the FCC must consider whether forbearance would promote competition and, if it finds that to be the case, forbearance may be appropriate. (Act, § 401(b).) Thus, Congress explicitly found that promoting and enhancing competition should be an overriding policy which guides the FCC in its interpretation and implementation of the Act.

Hence, the FCC's overriding goal should be to maximize consumer welfare by encouraging competition -- to exercise a bias in favor of an open, competitive telecommunications market, rather than an intrusively regulatory one, at every decision-making point.

1. The Consumer Interest in Fostering Competition.

A strong and principled policy basis underlies the Congressional decision to rely on competition rather than regulation to spur innovation and constrain prices. The social benefits of competition result from what economist Joseph Shumpeter called a "creative destruction" that keeps firms innovative and responsive to consumer demands. In Shumpeter's words, what really counts is --

"the competition from the new commodity, the new technology, the new source of supply, the new type of organization ... competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and outputs of the existing firms but at their foundations and their very lives."²

"Competition coordinates decentralized economic choices by individuals so they will

² Shumpeter, Joseph A., Capitalism, Socialism and Democracy, 3d ed. (New York: Harper & Row, 1950), p. 84, quoted in Stone, Alan, Public Service Liberalism: Telecommunications and Transitions in Public Policy (Princeton, NJ: Princeton Univ. Press, 1991), p. 46.

serve a community well."³ Competition is also more effective and efficient regulator of economic activity than is explicit regulation.

"[C]ompetition forces the suppliers of goods to keep the cost low.... In competitive markets consumers have many suppliers, and so if one does not satisfy them they will turn to others. Entry is unlimited, too, so a new firm may come into a market and force an inefficient one out of business. Thus, one side effect of competition, whether from within or from outside a market, is that firms fail. But consumers can be well served when the competitive process weeds out less efficient firms and imposes efficiency in those remaining."⁴

2. The National Interest in Fostering Competition and Innovation.

The transformation of the telecommunications market to a competitive one is also a necessity for the country. The marriage of telecommunications, computers, consumer electronics, entertainment, and publishing means that the public telecommunications system must renew itself much more rapidly if the industry and the economy it supports are to avoid becoming obsolete. If we are to continue on "the leading edge," our businesses must be free to innovate and provide better and less costly alternatives to obsolete technologies. Without this, consumers in all of their capacities will suffer.

Our history of regulation of telecommunications has reflected "concerns for orderly national economic growth, the more or less even social distribution of telecommunications benefits and the political accountability afforded, at least in theory, by state involvement." However, Professor Miller has concluded that there are certain costs: specifically, "lessened

³ Sherman, Roger, The Regulation of Monopoly (New York: Cambridge University Press, 1989), p. 4.

⁴ Sherman, Roger, The Regulation of Monopoly (New York: Cambridge University Press, 1989), pp. 54-55.

economic efficiency, laggard technological innovation and unresponsive bureaucracy."⁵

"In the long run, it is the efficiencies and network externalities of a high-technology telecommunications infrastructure that keep a nation or a region competitive in the contemporary world. It is in the context of telecommunications as infrastructure that the USA is beginning to lose ground to other nations which were late starters but are now economically and technologically advanced....⁶

"Telecommunications constitute the core of, and provide the infrastructure for, the information economy as a whole. From the standpoint of the user, telecommunications facilitate entry to the market, improve consumer service, reduce costs, and increase productivity.... Countries and firms that lack access to modern systems of telecommunications cannot effectively participate in the global economy."⁷

The questions the FCC must ask are whether a proposed interpretation or implementation of the Act will allow the competitive market to function as well as it might and must; whether private entrepreneurs will be willing to provide the energy and investment that are needed to fuel the Information Age for the nation; and whether the long-term best interests of the "whole consumers" of our country will really be served.

3. Avoiding Perversely Counterproductive Regulation.

In implementing Congress' mandated policy to promote the development and use of advanced telecommunications services, it would be perversely counterproductive to impede deployment of innovative services by forcing the providers to overprice them. That is particularly so if the rationale for overpricing such services is to lower the price of other

⁵ Miller, James, ed., Telecommunications Equity: Policy Research Issues (New York: Elsevier Science Publishers, 1986), 49.

⁶ Dholakia, Ruby Roy, and Nikhilesh Dholakia, "Deregulating markets and fast-changing technology: Public policy towards telecommunications in a turbulent setting," Telecommunications Policy (1994), 21-31, p. 25.

⁷ Saunders, Robert J., et al, Telecommunications and Economic Development (Baltimore, MD: Johns Hopkins University Press, 1994), p. 305.

services. The new technologies, if they are allowed to be implemented and to mature at the level determined by market demand, are likely to provide a much greater impetus to lower prices for consumers and promote universal service goals than any foreseeable program of mandated cross-subsidies.

By adopting the Act, Congress has opted in favor of the most powerful path that government can take to encourage investment, innovation, diversity and fair prices for telecommunications customers: greater reliance on the competitive market. Professor Bruce L. Egan suggests that telecommunications infrastructure development can best be encouraged by government in two ways: (1) "by pursuing a policy of deregulation and open market competition, which is government getting out of the way and allowing the private pursuit of profits through productivity and innovation;" and (2) by "government pro-investment initiatives such as flexible allocation of radio spectrum, tax breaks, universal service subsidies, and seed funding for achieving a critical mass for fledgling but promising technologies."⁸

It is important that the FCC not put a damper on that potentially dynamic process in the guise of protecting consumers or prospective competitors, since in this market, at this time, the best interests of consumers of all income levels call for the maximum feasible support from the market process.

For these reasons, the burdens of the universal service subsidy on the public telecommunications system should be kept as low as possible, consistent with providing access to the telecommunications networks by persons who would not otherwise have access.

4. The Regulatory Options

The goals of universal service are at least partly achievable without explicit govern-

⁸ Egan, Bruce L., "Building value through telecommunications: Regulatory roadblocks on the Information Superhighway, Telecommunications Policy (1994), 573-587, at p. 576.

ment intervention, provided that the dynamics of competition are fostered and mobilized.

Therefore, first and foremost, the FCC should seek to transform the industry into one in which competitive forces operate to their fullest. As viewed by Professor Egan --

"If policy makers truly want to stimulate private investment in the public telecommunications network via market forces, they should do it the old-fashioned way by eliminating restrictions on the market entry, profits, and the scope of operations of all market players."⁹

"Managed competition is an oxymoron, kind of like 'efficient regulation'. Regulators, in trying to have the best of both worlds at once, namely regulation and competitive entry, end up getting the benefits of neither, and the costs of both. They should have taken the high road of market discipline and promoted entry."¹⁰

"The real linchpin to achieve the vision of the so-called Information Age for the mass market is the adoption of government policies which promote private investment in public network technology . . ."¹¹

In interpreting and implementing the Act, the FCC and the Joint Board should strive to foster a telecommunications market where "consumer necessity" regulation makes consumer welfare the driver in the new telecommunications age. In a regulatory regime of "consumer necessity," competition is only a means to an end:

"It [competition] supplies a method for promoting consumer sovereignty through a dynamically evolutionary process of discovery and selection in the economic marketplace. The proper measure of the effectiveness of that process is how good a job it does meeting consumer requirements. Satisfaction of consumer tastes and preferences is the most basic and compelling measure of economic performance. Thus the question that should be relevant for public policy making is not how well

⁹ Egan, Bruce L., "Building value through telecommunications: Regulatory roadblocks on the Information Superhighway, Telecommunications Policy (1994), 573-587, p. 573.

¹⁰ Id., at p. 574.

¹¹ Id., at p. 574.

competitors make out in the competitive struggle, but how well consumers fare."¹²

The DCA urges the FCC to adopt a regime of "customer necessity" regulation that promotes the interests of consumers and the economy.

"Effective competition compels the adoption of an efficient structure of prices. That implies that customers who are cheaper to serve will pay prices that are lower than customers who are more expensive to serve. . . . It implies that any subsidies to achieve social objectives will have to be targeted specifically towards those in need and be funded collectively. It implies that investment decisions will be taken on the basis of real economic rewards rather than an artificial set of gerrymandered payoffs that depend on expansive regulatory protection and promotion. It implies that economic ability to compete effectively in the marketplace will count for more than legal ability to wage war in the regulatory arena."¹³

5. Guiding Principles.

In summary, there are at least three principles that the FCC and other regulatory bodies should use to guide the transition from today's regulated telecommunications market to a competitive one. First, the spirit of all regulatory efforts should be pro-competitive. Insofar as regulation is necessary, it should be viewed as a means to facilitate and encourage active competition, including competition in innovation, services, quality and price. Second, where intrusive regulation is needed, the scope of the activity subject to regulation should be as narrow as possible. Third, subsidies to users should be limited to those necessary to enable users to purchase essential services that are beyond their economic means.

C. States Should Interpret and Implement the Act with Respect to Intrastate and Local Exchange Issues.

The United States is a large melting pot of peoples and governments. The differences

¹² Haring, John R., and Dennis L. Weisman, "Dominance, nondominance and the public interest in telecommunications regulation," Telecommunications Policy (March 1993), 98-106. at p. 105.

¹³ Id., p. 105.

in peoples' goals, values, needs, wants and desires are as varied and diverse as the country's topography. Our dual system of government -- federal and state -- can sometimes be a source of conflict, particularly where, as here, there is some measure of justification for both a national and a local policy on telecommunications issues.

The DCA believes that the FCC should allow the individual states maximum flexibility in implementing the Act as it relates to intrastate and local exchange competition. The division of jurisdiction which has been applied up to this point -- with the FCC regulating interstate interexchange services and the states regulating intrastate and local exchange services -- has worked well and should be continued.

There are at least two reasons for continuing that approach. First, it does not overburden federal government. The interpretation and implementation of the Act will be extremely complex -- evidence the 65 pages and over 175 issues of the NPRM generated by only four of the Act's over 100 pages. When faced with managing a complex issue with a diverse population, the best approach is simple and broad-based, delegating as much authority as possible to the individual states.

Second, some issues, such as those relating to provision of services to schools, libraries and health care providers, are both highly complex and truly "local" in character. The needs of one state are likely to be quite different than those of any other.

Hence, the FCC should establish broad standards, principles, and rules, and allow the states as much flexibility and authority as possible to interpret and implement them.

III. APPLICATION OF THESE PRINCIPLES TO THE UNIVERSAL SERVICE SUBSIDY PROGRAM.

A. Design Universal Service Subsidies to Carry Out the Policies Which Justify Them.

Certainly not all goods and services in the economy justify the application of universal

service concepts. While there are principled reasons for adopting a universal access policy, any program of universal service should be designed with the purposes and goals of universal access in mind. Therefore, the questions that need to be asked include the question of what public purposes are served by promoting universal access.

While formal economic and social studies seem to be lacking, there are well-known and well-articulated social reasons that support the goal of universal service in telecommunications. They include the benefits that accrue from people being a part of a community and society: from being able to connect with others, and others being able to connect with us; and from entertainment, education, work-at-home, and many other uses.

There also are purely economic reasons that support a universal service subsidy paid by other telecommunications customers. One is that the value of telecommunications services to those who purchase and fully pay for the services increases with the number of customers on the network. As Colin R. Blackman has stated:

"There is value just in having people connected to a network, the so-called network externality argument. And the uneconomic customer of today may well turn out to be a competing operator's economic customer tomorrow. So there is a value to incumbent operators in keeping uneconomic customers connected. Indeed it is argued by some that providing universal service is not an obligation at all but rather an opportunity and a privilege."¹⁴

The indirect value of universal access includes the value to government and other public and private organizations whose operations are facilitated by widespread deployment of telephone services, which redounds to the economic benefit of people as both taxpayers and owners, employees and customers of those organizations.

Another economic reason that supports universal service is that maximizing

¹⁴ Blackman, Colin R., "Universal service: obligation or opportunity?" Telecommunications Policy (1995, Vol. 19, No. 1, 177-176, at 173.

participation by customers who can be added to the network at little marginal cost makes the most efficient use of fixed plant. This is a market incentive that is fully compatible with a competitive market in telecommunications services, and it also is the exact function that a well-designed universal service program performs.

The universal availability of telephone service also fosters a broader showcase for the sale of services such as new applications, related customer premises equipment, information services, and others. The resulting synergies create value for everyone.

B. Financing Universal Service Subsidies.

The current concept of "universal service" is a public policy to spread telecommunications to virtually all members of society. Since the early 1970s, making the funds available to support that public policy has been accomplished through a system in which some services are overpriced in order to provide others below cost. However, competitive inroads are limiting the ability of a monopolist to generate the funds for such internal cross-subsidies.

"Since the demands for funds for maintaining universal service have not declined, the old system has been propped up with great complexity. . . . [T]herefore, the question must be faced squarely: if we want to continue to assure the electronic interconnectivity of all members of society, how will we pay for it in a competitive environment?

". . . This question will not go away by the invocation of competition, but is actually made more urgent by it since monopoly profits would no longer be available for funding." ¹⁵

"The economic pressures . . . have convinced many regulatory authorities and telecom monopolies that it is in their interest to move to cost-based pricing." ¹⁶

¹⁵ Noam, Eli, M., "Beyond liberalization III: Reforming universal service," Telecommunications Policy (1994, Vol. 18, No. 9), 687-704, at p. 687-688.

¹⁶ Feketekuty, Geza, "Negotiating the world information economy," in Sapolsky, Harvey M., et al, eds., The Telecommunications Revolution: Past, Present, and Future (London and New York: Routledge, 1992), p. 182.

Moreover, Brookings Institution economist Robert W. Crandall has concluded that cross-subsidies are costly.

"[T]he attempt to use telephone rates as mechanisms for redistributing income is costly, reducing social output by more than two dollars for every dollar transferred from upper-income to lower-income households. It is far better to target subsidies to very low-income households through Universal Service funds or other mechanisms than to distort rates for all telephone subscribers."¹⁷

Promoting universal service by cross-subsidies also can be arbitrary. The current system of cross-subsidies makes assumptions that often do not square with the facts, and the results often are inequitable, if not perverse:

- Affluent residential customers are subsidized by low-income customers who make toll calls.
- Affluent residential customers in rural areas are subsidized by low-income residential customers and low-income merchants in the inner cities.
- The sons and daughters of affluent customers who are attending college or taking time off from school are subsidized by other customers.

While the social policies that depend upon statewide and nationwide averaged rates and other internal and external cross-subsidies were beneficial to both the industry and consumers when they were implemented, their necessity and validity have diminished now that infrastructure is in place to connect virtually all consumers to the public network.

C. Targeting Universal Service Subsidies.

While it is not true that a universal service subsidy and a competitive market cannot coexist, the task of reconciling the two competing values is a difficult one. It is the DCA's position that the universal service subsidy must be designed in a way that universal service can co-exist with competition; that means it must be a limited and carefully-crafted subsidy.

¹⁷ Crandall, Robert W., After the Breakup (Washington, D.C.: The Brookings Institution, 1991), p. 164.

In order to moderate the economic impact of any subsidy on the public telecommunications system, and also achieve equity among different classes of consumers, the DCA believes that the universal service subsidy should be targeted on consumers who would not have access to the networks without the subsidy. That means that the subsidy: (1) should not be available to those who do not need it to achieve access; (2) should not be needlessly large for those who are entitled to receive it; (3) should be deployed in ways that are most beneficial to the short- and long-term interests of all of society, including those who bear its burden and those who receive it; and, (4) should be deployed in ways that will accord its recipients the maximum feasible flexibility in using it.

The function of the subsidy should only be to achieve universal service -- a broadening of access to include virtually everyone -- and not just a means to redistribute income among classes of customers or geographical areas. This is so because there are important trade-offs to consumers. The larger the universal service subsidy, the greater is its cost, and the greater is its negative impact on the speed with which the telecommunications age advances, both for those customers who receive the subsidy as well as for those customers who fund it.

Also, those who elect to live in rural areas recognize, when they make that choice, that rural living results in a variety of cost savings for some things (e.g., auto insurance), but that it also creates cost increases for other things (e.g., property taxes, commuting, and food). Hence, it is not inequitable that consumers who choose to live in rural areas pay the true cost of providing their telecommunications services.

Each of the economic reasons which the DCA has identified above supports some level of a universal service cross-subsidy, but each has inherent limits: at some point, as the

amount of the subsidy increases, its economic rationale disappears. Since the cost accounting that would establish that point probably is unavailable, no one can determine precisely at what point a subsidy of this kind becomes uneconomical. In a competitive market, competitors would make these decisions subject to marketplace constraints, and ultimately, the market itself would make those determinations. Now, it usually is a regulatory decision. The DCA believes that to the extent possible, this should be a marketplace decision; and to the extent that it must remain a regulatory decision, it should be made with an eye to the market, limiting the subsidy to the amount that providers would probably allocate in a competitive market with all participants knowledgeable about and mindful of their interests.

IV. SUGGESTED INTERPRETATION OF SPECIFIC PORTIONS OF THE ACT RELATING TO UNIVERSAL SERVICE.

The DCA believes that any geographic high-cost subsidy program should be structured around three important policies: (1) that all subsidies should be focused on those who really need them (that is, those who otherwise could not afford the services); (2) that those who receive the subsidy should be aware of the amount of subsidy they receive; and (3) that those who fund the subsidy should be aware of the amount they are contributing to it.

The DCA is concerned that a broad interpretation of the Act by the FCC could result in an unfocused subsidy to all customers in high-cost geographical areas. It would provide subsidies to affluent residential customers, and its funding would not be explicit. We are concerned that without a focused subsidy, low-income, inner-city customers might subsidize affluent rural customers, and telecommunications providers could be deterred from offering more efficient, lower-cost technologies in high-cost areas. Ultimately, unless the high-cost area subsidy is focused, it could become a monstrous albatross around the necks of the nation's average consumers and businesses. The FCC must be careful not to apply the Act

in ways which make low-cost telephone service an "entitlement."

A. What Are "Reasonably Comparable" Rates?

The Act requires that the FCC and the Joint Board base the policies and principles for advancing universal service on several principles, one of which is that telecommunications and information services, including interexchange and advanced telecommunications services, be available to consumers in all regions of the nation, including low-income consumers and those in rural, insular and high-cost areas, at rates that are "reasonably comparable" to the rates charged for similar services in urban areas. (Act, § 254(b)(3).)

The manner in which this provision is interpreted will have a profound effect on the extent to which competition and innovation in the telecommunications and information services industries are encouraged and promoted. The DCA believes that while it may be appropriate for the FCC to establish some broad-based policy on this issue, the FCC should allow the states to determine what constitutes reasonably comparable intrastate and local exchange rates. To the extent that the FCC deems it necessary to interpret this provision, the DCA provides the following suggestions and guidance.

Rate regulation and rate averaging significantly influence the speed and extent to which competition will emerge. The greater the restriction on a market participant's ability to respond to customer demand with flexible pricing, the more competition will be deterred and delayed. Less competition means there is less pressure to be efficient and reduce prices.

In determining how to interpret and implement Section 254(b)(3), we note that it does not require that the rates for rural customers be identical to those for urban customers. If that had been Congress' intent, it would have written this provision as it did Section 254(g), where Congress requires that interexchange and interstate service rates for customers in rural

and high-cost areas be "no higher than" rates charged for the same services in urban areas. Hence, it seems logical to conclude that Congress intended that "reasonably comparable" rates are something less than "no higher than" rates, and that under a proper interpretation of Section 254(b)(3), some rates will be higher than others. The question that still must be answered is -- what range of rates constitutes "reasonably comparable" rates?

As a general rule, the reasonable price of a product is the true cost of providing it to the purchaser. In evaluating the reasonable cost of manufactured goods, most people agree that the manufacturer is morally entitled to receive the cost of manufacturing the product, including a margin for profit.

When circumstances create additional costs for some but not all purchasers, those costs usually are passed on to the customers that necessitate the increased cost. For example, virtually no one argues that it is unreasonable for the price charged for products transported to, and sold in, remote areas to reflect the additional cost of transporting them to that area. As another example, car insurance usually costs less in rural areas than in more densely populated areas where the risk of losses are increased by the number of drivers on the road, the types of traffic in which they drive, and other factors that increase insurers' costs.

The same rules should apply to telecommunications, particularly as it becomes the subject of a truly competitive market as Congress envisions. In that new market, the reasonable price of a service should relate closely to the cost of providing the service. Applying that analysis, a rate for services provided to rural customers is "reasonably comparable" to the rate for services provided to urban customers if the rural customers' rate includes the additional costs (if any) incurred by the telecommunications provider to provide service to the rural customers.

B. What Are "Just, Reasonable and Affordable" Rates?

The Act also requires the FCC and the Joint Board to base the policies and principles for advancing universal service on the principle that "[q]uality service should be available at just, reasonable, and affordable rates." (Act, § 254(b)(1). [Emphasis added.]) In fact, the only "consumer protection" relating to universal service required by the Act is that the FCC "ensure that universal service is available at rates that are just, reasonable, and affordable." (Act, § 254(i).)

The manner in which this provision is interpreted also will have a profound effect on whether the U.S. will have, and benefit from, a truly competitive telecommunications market which offers advanced telecommunications services. The DCA believes that while it may be appropriate for the FCC to establish some broad-based policy, the FCC should allow the states to determine what constitutes just, reasonable and affordable intrastate and local exchange rates. To the extent that the FCC interprets this provision, the DCA provides the following suggestions and guidance.

With respect to the first requirement -- that rates be "just" -- probably everyone can agree that "just" is normally defined as fair, and consistent with moral right. (American Heritage Dictionary (2d college ed. 1985) page 694.) As a general rule, our society's view of fairness requires that each person pay for his or her share of the cost of something he or she uses, or from which he or she benefits. Most people agree that it is "unfair" to impose that burden on other customers. While we make exception for the poorest in our society, that exception is narrowly tailored and strictly limited.

For example, food is necessary to sustain life. Food purchased near the places where it is grown usually costs less than food that must be transported to remote areas, as do

gasoline and other products. Some people who live in areas remote from farms are in great economic need. Nonetheless, we have not found it necessary to create a complex universal service subsidy program to subsidize the price of food or gasoline in those areas. Perhaps that is because society considers it "just" and "fair" that the people who cause that additional cost should be the ones who pay it. Although we provide some assistance through the food stamp program, it is focused only on those who need economic help, and the amount of the assistance is not increased based on the cost of food in a given region of the country.

Applying this rule to telecommunications, "just" rates are rates that, to the extent possible, reflect the true cost of providing service. Where those costs differ based on geography or some other factor, it is just and fair that those customers who cause the increased cost to provide service should pay that increased cost.

As to the remaining two requirements, many consider the terms "reasonable" and "affordable" to be synonymous. It is very significant that the Act recognizes that those terms are not synonymous. Recognizing and appropriately applying the difference between the two terms is critical to the proper interpretation of the Act.

In Section IV.A., the DCA discussed the meaning of "reasonable" in the context of telecommunications rates. The DCA believes that same interpretation also should apply here. Thus, a "reasonable" rate presumptively is one which reflects the true cost to provide service -- a cost which may differ based on density, geography, climate or other factors.

The real question then becomes -- when is the reasonable price of providing basic service not an affordable rate. In the DCA's view, the answer to that question must depend on the income of particular customers -- their economic ability to purchase the service. For example, assume that there is a geographic service area ("GSA") where the cost to provide